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FCPA Alert

U.S. and U.K. Authorities Reach Ground-Breaking Settlement with BAE Systems

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On February 5, 2010, British defense contractor BAE Systems plc ("BAES") announced that it had reached a settlement with the United States Department of Justice ("DOJ") (subject to final court approval) to pay $400 million and with the United Kingdom Serious Fraud Office ("SFO") to pay £30 million in connection with the long-running bribery probe of BAES's world-wide activities. According to the company's press release, the proposed settlement with the DOJ will also involve "additional commitments concerning its ongoing compliance." While the press release does not spell out exactly what these "additional commitments" will entail, history shows they could range anywhere from yearly certifications of FCPA compliance to the appointment of an FCPA monitor.

As described in more detail below, the prosecution and resolution has far reaching implications in a number of respects. It should be noted at the outset that the DOJ imposed the $400 million fine without even bringing a charge directly under the Foreign Corruption Practices Act ("FCPA"). Instead, the government charged BAES in a one count criminal information (the "Information") with conspiracy (under 18 USC § 371) to make false statements to the U.S. Department of Defense in a written commitment to maintain an adequate anti-corruption compliance program, and for causing an export license application to be filed that failed to disclose payments to third parties. The prosecution and resolution highlights the dramatic reach of anti-corruption efforts, the risks posed to companies making undertakings and representations to the United States government (which can arise in a variety of circumstances), and the pitfalls facing federal contractors and companies subject to U.S. export restrictions.

BACKGROUND

BAES, Europe's largest defense contractor by sales, had been under investigation since 2004 for several transactions in the 1990s, including in Saudi Arabia, South Africa, Tanzania, Romania, and the Czech Republic. According to the Information, BAES maintained a practice of using "marketing advisors" to assist in securing sales around the world. BAES allegedly made an effort to conceal some of these relationships and misrepresented the amount of oversight and scrutiny the company gave to substantial payments under these agreements. BAES established various off-shore shell companies (including a company in the British Virgin Islands) through which it paid these marketing advisors and encouraged some of the advisors to establish their own shell companies to receive the payments in an effort to conceal the relationships. The DOJ further found that these shell companies were formed to hide the name of the agent and how

much the agent was compensated, to create obstacles for investigative authorities, and to circumvent laws of countries that do not allow agents (or to assist the agents in avoiding tax liability).

In a 2000 letter to then-U.S. Defense Secretary William Cohen, BAES Chief Executive John Weston stated that BAES "[is] committed to conducting business in compliance with the anti-bribery standards in the OECD Anti-Bribery Convention" and the U.S. FCPA. In addition, the letter pledged that BAES would adopt compliance programs, including "controls concerning payments to government officials and the use of agents," to ensure compliance by all of its affiliates. Then, on May 28, 2002, in correspondence with the then-U.S. Under Secretary of Defense, BAES reasserted the claims it made in the letter to Mr. Cohen in 2000. The Information specifically alleges that at the time of these letters, BAES was not committed to the practices and standards it had represented to the U.S. government.

The DOJ ultimately charged BAES with one count of conspiracy to knowingly and willfully make false statements to the U.S. government with respect to the company's compliance with provisions of the FCPA and OECD in violation of 18 U.S.C. §1001, as well as false or misleading statements in applications for arms export licenses in violation of the Arms Export Control Act ("AECA"), 22 U.S.C. §2778 and 22 C.F.R. §§127 & 130. As part of the settlement with the DOJ, which is subject to court approval, BAES will plead guilty to the one count of conspiracy. The DOJ charged BAES for conduct with respect to contracts in Saudi Arabia, the Czech Republic and Hungary. Importantly, the company was not charged with bribery or corruption in either the U.S. or U.K., which could have barred it from bidding on U.S. and European defense contracts. The Information specifically excluded the activities of BAES's wholly-owned U.S. subsidiary, BAE Systems Inc. According to the Information, BAE Systems Inc. is subject to a Special Security Agreement ("SSA") with the United States government. This SSA necessarily restricts the amount of control BAES is able to exercise over BAE Systems Inc.

In its settlement with the SFO, BAES admitted to accounting irregularities with respect to a deal to sell an air traffic control system to Tanzania. The large discrepancy in the amount of the DOJ and SFO fines can be explained by the SFO's inability to charge BAES with respect to the al-Yamamah contracts in Saudi Arabia. In 2007, then-British Prime Minister Tony Blair called off the U.K. investigation into the Saudi Arabian contracts.

Saudi Arabia

The heart of the settlement with the DOJ was the al-Yamamah contracts in Saudi Arabia, which have reportedly earned BAES more than £43 billion ($80 billion) over the last 25 years. Beginning in the mid-1980's, BAES began supplying aircraft to the U.K., which in turn sold them to Saudi Arabia. According to the Information, BAES agreed to transfer sums of more than £10 million and $9 million to the Swiss bank account of a marketing advisor while knowing there was a high probability that the marketing advisor would transfer a portion of these funds to Saudi officials in order to influence the decision on these contracts. In addition, the Information alleges that BAES provided substantial benefits to one Saudi Arabian official (and his associates) who was in a position to exercise significant influence with regard to the al-Yamamah contracts. According to the Information, BAES failed to perform adequate due diligence on both its relationship with the marketing advisor and the support services payments to the government

official. This conduct, according to the DOJ, was in contradiction to the commitments the company made in its letters to the Department of Defense in 2000 and 2002.

Czech Republic & Hungary

In 1999, both the Czech Republic and Hungary sought bids by major defense contractors for the sale of fighter jets. Ultimately, the two countries separately decided to lease Griphen fighter jets, produced by BAES, from the government of Sweden. According to the Information, BAES made payments of more than £19,000,000 to various entities associated with an individual identified in the Information only as "Person A." These payments were allegedly made even though BAES knew there was a high probability that part of the payments would be used to make improper payments in order for the bid processes to favor BAES. Additionally, the Information specifically alleges that BAES did not perform proper due diligence with respect to its relationship with entities associated with Person A, contradicting what the company had reported to the U.S. government. Finally, because U.S. defense materials were used in the jets, the government of Sweden was required to apply for and obtain arms export licenses from the U.S. for each contract. BAES allegedly withheld the existence of payments to Person A from the government of Sweden, thereby causing Sweden to provide false information in its application.

ANALYSIS

The following are some of the more important takeaways from the DOJ's prosecution of, and resolution with, BAES.

Need for Due Diligence

While using a slightly different melody, the BAES resolution continues the DOJ's consistent tune that the failure to conduct proper due diligence can lead to a violation even absent specific findings by the DOJ that illicit payments were made. In the 2007 Baker Hughes settlement, the DOJ found that the failure to conduct meaningful and appropriate due diligence is tantamount to a books and records violation. (See Baker Hughes Alert dated May 2007).[1] In the BAES case, the DOJ found that the failure to conduct due diligence violated BAES's assurance that it had an adequate compliance system, including with respect to its use of commercial agents. In effect, the DOJ found that the failure to conduct due diligence was a significant factor militating in favor of a finding that there was a high probability that bribes were paid. While the presence of the undertakings by BAES put the case on potentially different footing than most, the import of the message regarding due diligence is unmistakable and companies are again reminded that they proceed with a commercial agent absent due diligence at considerable peril.

Need to Document the Activity of Agents

Amplifying another verse from the Baker Hughes hymnal, the DOJ in BAES reminds the business community in the clearest terms to date that not only must a company conduct pre-appointment due diligence, but it must also document and review for appropriateness and adequacy the work purportedly performed by agents. Paper processes will not suffice. Rather, companies are expected to substantively review and value the effort put forth by an agent prior to authorizing payment, with the prospect that payments made without proper support or that are

[1] Available at www.hugheshubbard.com/Baker-Hughes-Settles-FCPA-Charges-With-DOJ-and-SEC-05-08-2007/.

objectively excessive can be considered evidence of a high probability that the payments are being made to fund (in whole or part) a bribe.

"High Probability" Standard

Though the DOJ did not charge BAES with any violation of the FCPA, the case involves BAES's failure to maintain an effective anti-corruption compliance program, as it had pledged in its letters to the Department of Defense. The Information repeatedly states that BAES failed to maintain an effective anti-corruption program because it ignored signaling devices that should have alerted it of a "high probability" that third parties would make improper payments. The frequent invocation of the "high probability" language and the reliance on circumstantial factors should be taken as a stark reminder of the DOJ's willingness to rely on this constructive knowledge element of the FCPA and a further reminder that the standard can be seen as satisfied by the DOJ where conduct falls short of actual knowledge.

Suspect Jurisdictions

The Information also provides a firm reminder that conducting business in or through suspect jurisdictions is a red flag. The DOJ took particular issue with BAES's utilization of both the British Virgin Islands and Switzerland as jurisdictions notorious for discretion. Companies are well advised to ensure that there is a legitimate reason for the use of such jurisdictions, as opposed to using them as a masking technique or for an illicit motive (such as inappropriate tax avoidance by the agent).

Broad Jurisdictional Reach

We pointed out in our 2009 Mid-Year Alert that U.S. enforcement authorities were taking more expansive jurisdictional views in connection with anti-corruption enforcement. Increased non-U.S. participation adds to the continued derogation of jurisdictional defenses as regulators from other countries may be able to reach conduct falling outside of the jurisdiction of the FCPA. In addition, U.S. authorities' use of other statutes to bring charges in many ways expands their ability to punish corrupt conduct, even where the entity at issue is based outside the U.S. and its U.S. subsidiaries are expressly not implicated.

Use of Related Statutes

The BAES case demonstrates the continuing use by U.S. authorities and other regulators of complementary statutes (such as export control laws or false statement statutes) to bring bribery-related charges without actually having to prove all of the elements of an FCPA violation. The interconnectivity of the various statutes, and the relative ease by which certain of them can be established, is a reminder not to take an overly technical view when providing FCPA counseling.

- ***Export Control and Government Contracts Connection*** - Government contractors and companies subject to U.S. export controls may face heightened scrutiny and risks with regard to anti-corruption compliance. As the BAES case illustrates, such companies may be required to make representations to the government, which can themselves become the source of legal liability. Such companies must not only be cognizant of anti-corruption rules, but also the legal

liability they face for making statements regarding their anti-corruption efforts as part of regulatory schemes such as the export control laws and federal acquisition regulations. As the DOJ's push to broaden anti-corruption enforcement continues, this intersection of different enforcement regimes will become even more important.

- ***Breadth of the False Statement Statute*** - The willingness of the DOJ to take a more expansive approach to anti-corruption enforcement is underscored by the use of the false statement statute, which generally can reach a wide-range of conduct, from informal communications (such as the letters sent by BAES to the Department of Defense) to court, regulatory, or congressional testimony. Companies must be cognizant that they will be held potentially accountable for virtually any representation made to the U.S. government or a U.S. government official regarding anti-corruption compliance.

If you would like to discuss the information contained within this Alert or other related matters in more detail, please contact:

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